Chairman’s statement 2017

Ian Brimecome

Dear members

Following a year full of unprecedented economic and political turbulence, we are pleased to say that we have been able to maintain the 35% capital distribution payable to with-profits policyholders.

Falling interest rates

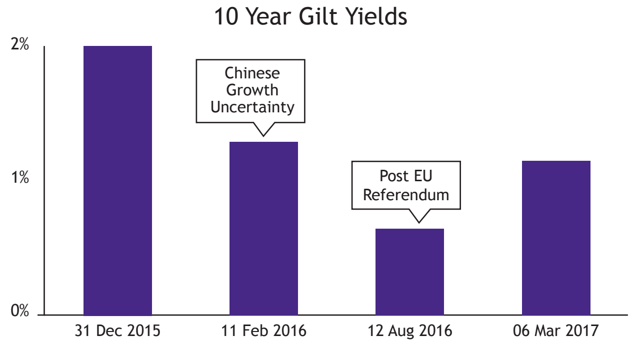
When interest rates fell very sharply last year in February and then again in August following the Brexit vote, I have to say that we did not feel quite so confident in our ability to maintain capital distribution. Our reasoning is straightforward. The greatest risk that the Society faces is policyholders deferring retirement at a time when interest rates are very low. This combination of factors was exactly what took place in 2016.

Many of our with-profits policies have a built-in guarantee of 3.5% pa. We have invested our assets to be sure that we can pay these guarantees, based on when we think policyholders will retire. The Society is exposed to the risk that policyholders stay longer than we expect when we are not able to earn that 3.5% pa return. Consequently, we are required to hold back capital to cover that risk.

In early 2016, as Chinese growth prospects materially reduced, worldwide financial markets tumbled. The flight of cash from company shares to government securities such as UK gilts was very marked and, in consequence, interest rates fell significantly.

Then, in August 2016 following the Brexit vote, the Bank of England cut overnight interest rates by half.

For the Society, the most important interest rate warning indicator is the level of ten year gilt yields. The graph below shows all too clearly the dramatic changes since the end of 2015.



If ten year gilt yields fall below 0.5% and policyholders defer their retirement, capital distribution of 35% becomes very much more difficult to support under the new regulations introduced in 2016, known as Solvency II.

Mitigating interest rate risk

In the light of last year’s market turbulence, we considered carefully what could be done to bring rather more stability to capital distribution. Our most significant step was to seek approval from our regulators for a more gradual transition to the new solvency regulations. We are pleased to say that this application was successful. This means that the amount of additional capital required under Solvency II can be phased in over 16 years. In this very low interest rate environment, such phasing does a great deal to remove the pressure for a reduction in capital distribution.

Recreating policyholder value

The Equitable Life is a closed mutual in run-off. Solvency regulations are not designed with that sort of organisation in mind. Our driving force is to get capital back into your hands. This is very different to an organisation open to new business which needs to hold capital back to support future growth. We would very much wish to be able to make a greater capital distribution to policyholders when they leave, ever mindful that policyholders who might remain for longer periods do not end up getting a lower amount. This is no simple balancing act but, rather, goes to the heart of whether our strategy is really being successful.

Recreating policyholder value remains our mission. We are determined to distribute all of the Society’s capital among with-profits policyholders as fairly and as soon as possible. This strategy has served us well since it was launched in 2010. Seven years on, I provide a current perspective of what “as fairly and as soon as possible” means today and in a post-Brexit world. This will act as a guide to the next steps in our strategic thinking.

As fairly as possible

Every day, we have to make decisions that we must judge to be fair. Yet, by its very nature, fairness is a subjective concept. We therefore give a great deal of thought to the considerations that should underpin fair outcomes for policyholders. For example, proposals must be logical and capable of being communicated so that they are understood. Furthermore, any proposal should provide consistency from policyholder to policyholder and, where that is not feasible, there needs to be a good explanation as to why not.

Perfect fairness may be something that is desirable, but it is unattainable. Our use of “as fairly as possible” recognises this and, in coming forward with proposals, the Board acknowledges that there will necessarily be gradations of fairness, so long as overall there is a greater degree of fairness.

As soon as possible

The total capital that we hold in case things go wrong is c£1bn; some 20% of the assets we manage on behalf of with-profits policyholders. A material proportion of that capital is held because the solvency regulations stipulate the amount. For a normal company, one which is expecting to grow, that would be entirely sensible. But Equitable is not a normal company. We are in run-off.

Given the considerable volatility of 2016, the obvious question is what confidence do we have about capital distribution in the future. To help here, we evaluate the impact of many different future scenarios which allow for the possibility of events such as stock market collapses or mass policy surrenders.

In the majority of scenarios, capital distribution rises somewhat over the next ten years or so and there is a small chance that it could rise considerably. More worryingly, there are events that could cause the capital distribution to be reduced to zero, such as the very low interest rates experienced in 2016.

Low interest rates have been something that we have had to face up to for a number of years now. Having said that, no one forecast that they would fall to such levels. An important consequence of low interest rates is high asset values. That brings with it our greatest strategic challenge: how to give you credit for those high asset values which will inevitably reduce in the years ahead if interest rates rise.

A simple example will bring the previous paragraphs to life. Consider you have a policy with a current value of £10,000 of which £7,500 is guaranteed in any circumstance. If you wish to cash in your policy right now, the Society can pay you £13,500, being the £10,000 current policy value plus the capital distribution of 35% referred to above (as it is higher than your guaranteed amount). However, the actual fund potentially available in regard to your policy is c£15,000, but the regulations require us to retain £1,500 to cover financial shocks that would affect our ability to pay other policyholders.

So, policyholders are faced with a choice. The only amount that is certain is the guarantee (£7,500). The capital distribution is currently 35% and we are looking at ways of improving it but, if the future does not turn out as we hope, there is the potential to lose at least £3,500 (35% of £10,000). Or policyholders can wait in the hope that the £15,000 will eventually become payable.

In 2017, we intend to investigate deeply our options to address the challenge of low interest rates and, in particular, we shall explore how we can make more certain the 35% uplift currently paid to policyholders when they retire. We will also explore what can trigger payment of the £1,500 balance referred to in my example above.

Policyholder retirements

While a greater number of policyholders cashed in their benefits in 2016 than had been seen for some years, there is nevertheless a clear underlying trend for policyholders to defer taking their benefits until after the retirement date that we had been assuming.

We can speculate as to what might be at the heart of this phenomenon. It could simply be policyholders working for longer; it could be that policyholders' savings with the Equitable are a small part of their investment and are treated as rainy day money; it could be that the relative returns on Equitable policies over recent years have been rather better than may have been expected. The fact is we do not know. If we did know, we could predict better your likely intentions; and we would be able to manage your savings optimally. In particular, we would more likely be able to pay out a higher level of capital distribution more quickly.

We learned in 2016 that the prospect of a reduction in the 35% capital distribution is something that policyholders would prefer to avoid, particularly if they are intending to cash in their policies in the next year or two. This is entirely understandable. The trouble with economic shocks is that they are just that, and sometimes it is simply not possible to give any notice of the consequence on your savings.

Listening to policyholders

In order to help guide us in our decision making, we seek many means to find out what policyholders think. Focus groups can be very helpful in helping us design communications which you understand. Your insightful questions at our Annual General Meeting inevitably give us great pause for reflection. The Equitable Members Action Group can be relied on always to give a penetrating perspective. This sort of direct feedback is immensely valuable and we are grateful to policyholders who give up their time to assist. We listen carefully and, while we are unable to meet the wish of every policyholder, we do listen.

We also write to thousands of policyholders every year asking them to give very specific feedback on a small number of questions. One such question is whether or not policyholders consider the Society to be going in the right direction. In 2016, there was a notable increase in the number of policyholders who were no longer as sure as they had been. We are certain that this change of sentiment reflected the content of last September's letter where we warned that the capital distribution might have to be suspended.

Following our successful application for a more gradual transition to the new solvency regulations, we wrote to policyholders in January to express our greater confidence in maintaining the 35% capital distribution. We followed up this letter with a new survey and there has been a substantial increase in policyholders saying that they think that the Equitable is moving in the right direction.

The Society's costs

The Society's cost base continues on a strong downwards path. In 2016, net operating expenses were £37m, down from £43m in 2015. Similarly, business-as-usual costs reduced to £24m, down from £26m in 2015. A significant reason for this reduction was that we managed down staff numbers by more than 70 to 242. Essential to the success of the Society is a motivated and engaged workforce, so staff reductions at the level experienced have to be managed well. We put great store on being open with our staff on what run-off means, staying true to the Society's values of delivering for policyholders, transparency, fairness and affordability.

In the latest staff survey at the end of 2016, the vast majority clearly understood their role in recreating value for policyholders and agreed that Equitable is a good place to work. The Board would like to thank all our staff for their contribution and commitment to delivering policyholder value.

Facing the future

We welcome Lord Finkelstein to the Board as a non-executive Director. Daniel Finkelstein's wide experience will bring a welcome new perspective to the Equitable. As the Society develops the next phase of its strategy to distribute capital to with-profits policyholders as fairly and as soon as possible, Daniel's wisdom and insight will be of unique importance.

We began 2016 facing turbulent markets at exactly the same time as a change in the solvency regime. We successfully navigated those very choppy waters, and we begin 2017 confident that we can continue to find ways to recreate value for our policyholders.

The Society's Annual Report and Accounts are available at www.equitable.co.uk.
If you have requested a paper copy, this will be sent to you shortly.

Directors’ remuneration report

The total emoluments of the Directors were as follows:

Executive Directors’ emoluments

	Salary		Performance related bonus		Benefits		Long-term incentive plan		Total	
	2016 £	2015 £	2016 £	2015 £	2016 £	2015 £	2016 £	2015 £	2016 £	2015 £
C M Wiscarson	450,000	450,000	-	-	123,062	105,020	-	-	573,062	555,020
S A Small	229,500	229,500	137,700	114,750	71,667	68,229	-	135,000	438,867	547,479
Total	**679,500**	**679,500**	**137,700**	**114,750**	**194,729**	**173,249**	**-**	**135,000**	**1,011,929**	**1,102,499**

Executive Directors’ emoluments have been audited by PricewaterhouseCoopers LLP.

Non-executive Directors’ fees

Non-executive Directors receive only fees and are not eligible to receive benefits, pension or any annual or long-term incentives. Non-executive Directors’ remuneration, other than that for the Chairman, is set by the Board. The Chairman’s remuneration is set by the Remuneration Committee.

Fees are set by reference to market data, and the Board has discretion to increase fees periodically. Fees were increased from 1 January 2016, the first such increase for non-executive Directors since 2012, and for the Chairman since 2013.

Fees for the non-executive Directors are as follows:

	Annual fee	Effective from
Chairman	£150,000 pa	1 January 2016
Senior Independent Director and Chair of Audit and Risk Committee	£60,000 pa	1 January 2016
Other non-executive Directors including Chair of Remuneration Committee	£50,000 pa	1 January 2016

Executive Directors’ remuneration policy

Executive Director remuneration comprises salary and an annual performance bonus together with benefits comprising travel, private medical insurance, income protection and life insurance, and payments in lieu of pension contributions. Details are set out in the following table.

Base salary

Value

Chief Executive: £450,000 pa; Finance Director: £229,500 pa.

Reviewed annually with changes, if applicable, usually effective from 1 January. Promotion or an increase in responsibility could lead to a higher increase than that made to other staff at the Society.

Total remuneration is referenced to Willis Towers Watson survey data. We may pay higher salaries and total remuneration for strongly performing individuals or to attract and retain executives of the right calibre.

Benefits

The Society does not provide an occupational pension scheme for Directors. A cash allowance is provided in lieu.

The Society also pays the premiums on behalf of Directors relating to private medical insurance, income protection and life assurance.

London is the principal place of work for executive Directors. When Directors are required to travel to the Society's Aylesbury office, the associated costs are covered by the Society.

Maximum potential value

Cash allowance in lieu of pension: Chief Executive: £70,000 pa; other executive Directors: 10% of base annual salary.

Insurance premiums vary year by year. The current annual cost is shown in the executive Directors' emoluments table. The costs of travel to Aylesbury vary year by year in line with business needs.

Discretionary annual bonus

Rewards achievement of key deliverables in the relevant financial year.

Maximum potential value

80% of base salary.

For the remainder of his employment with the Society the current Chief Executive is eligible for consideration for a bonus of up to 25% of his basic salary for exceptional performance.

Operation

Performance is monitored throughout the year, and a formal assessment is presented to the Remuneration Committee at the half year and year end.

Where performance is on target, typically 75% of the maximum bonus is paid but, in some circumstances, it may be lower. Where performance is assessed as exceeded, bonus of up to the maximum is payable. Where performance does not reach on target level, no bonus is payable.

50% of the sum awarded is deferred, and subject to malus, with the deferred amount being paid in equal instalments on the three anniversaries following initial payment.

Up to 100% of the gross sum is subject to clawback.

Performance metrics

A scorecard is agreed each year setting out specific performance objectives. Objectives are determined so that the interests of bonus scheme participants and of policyholders are aligned. In particular, there is a strong focus on ensuring that executives act in ways that achieve business stability through, for example, treating customers fairly and prudently managing risk.

In addition to the discretionary annual bonus, in the event of a corporate transaction, the Society may introduce a retention bonus arrangement, linked to value created, to ensure executive Directors remain with the Society during a period of uncertainty. It is not possible to set out the terms of such an arrangement in advance as they would arise from the specific circumstances at the time. Disclosure would follow in the Directors' remuneration report in the year following the establishment of such an arrangement.

Comment on Resolution 4

Resolution 4 would, if passed, increase the maximum limit on the aggregate amount of the Directors' fees payable in any twelve month period ending on 31 May. The Board (in regard to non-executive Directors) and the Remuneration Committee (in regard to the Chairman) have power, within the limit set, to decide the actual level of fees – both in total and for individual Directors – having regard particularly to the various duties of the individual Directors and to the general level of fees appropriate from time to time. Executive Directors do not receive fees.

The current maximum limit is £375,000. This was set by way of Ordinary Resolution at the Annual General Meeting in May 1997.

In proposing a new maximum limit of £500,000, the Board is asking the Society to set a limit which can remain in force for a number of years and which will allow for the appropriate expertise and experience to be added to the Board as we seek to meet the next phase of our strategy of recreating policyholder value.

Board of Directors

The Board reviews the performance of Directors on a regular basis. Following this formal evaluation, the Board recommends that those retiring at the AGM should be re-elected and confirms that it considers that they continue to make a valuable contribution to the effective functioning of the Board and to the appropriate mix of skills and experience needed by your Society.

Ian Brimecome - Chairman

Ian Brimecome was appointed Chairman in September 2009. He joined the Board in January 2007 and is Chairman of the Nominations Committee. Ian is Chairman of Axa UK plc, Tokio Marine Kiln Group Ltd, Tokio Marine North America, Delphi Financial Group and HCC Holdings. He is also Executive Chairman International of Tokio Marine Holdings, Deputy Chairman of Tokio Marine Asia and a non-executive Director of Edelweiss Tokio Life. Ian has more than 30 years of experience of the financial services industry in a wide variety of roles and has advised on more than 100 merger and acquisition transactions in the insurance and asset management industries in more than 20 countries.

Keith Nicholson – Deputy Chair and Senior Independent Director

Keith Nicholson joined the Board in August 2009. He was appointed Deputy Chairman on 1 July 2012 and chairs the Audit and Risk Committee. Keith left KPMG in 2009 after more than 30 years with the firm. He has a wealth of experience with financial services companies covering audit and advisory roles. These included FTSE 100 companies in the UK and non-UK multinationals. Keith is Chairman of Liberty Specialty Markets. He is also the Senior Independent Director of JRP Group plc.

Chris Wiscarson – Chief Executive

Chris Wiscarson was appointed Chief Executive in September 2009. Before that, he was a member of the Group Executive Committee at Lloyds Banking Group. He started his career with Equitable Life, before moving to South Africa in 1979. In 1986, he returned to England to take up the position of Chief Executive of Save & Prosper Insurance. In 1990, he joined the Lloyds Banking Group, where he held a number of senior roles including Finance Director of the Lloyds Abbey Life Group, then Chief Executive of Lloyds TSB Life. At the beginning of 2000, he was appointed the Director responsible for the non-UK businesses in the Lloyds TSB Group before taking up the position of Group Integration Director.

Simon Small – Finance Director

Simon Small joined the Society as Finance Director in July 2012. He is responsible for the Society's Finance, IT Change, Company Secretariat and Investment functions, and takes a lead role in capital and strategic planning. Simon, a qualified accountant, has particular expertise in the financial and administrative aspects of operations and IT. He had previously worked at Lloyds Banking Group for over 20 years, latterly as the Finance Director to the team responsible for delivering the synergy benefits in the merger of Lloyds TSB and HBOS. Simon's expertise includes deal negotiation, restructuring company finances and delivering efficiency savings.

Penny Avis

Penny Avis joined the Board in January 2015. A Chartered Accountant, Penny is a former Deloitte corporate finance partner with wide-ranging merger and acquisition and accounting experience. Penny was an elected non-executive Board member at Deloitte UK LLP responsible for oversight of executive management and acted as a mentor to partner-track directors. Prior to Deloitte, Penny worked for PwC and Arthur Andersen. She is also a non-executive Director at Envestors Ltd, a private corporate finance business, Cifas, the UK's fraud prevention service and city law firm, Howard Kennedy.

Daniel Finkelstein

Daniel Finkelstein, Lord Finkelstein OBE, joined the Board on 17 March 2017. A journalist and Conservative politician, Daniel has been a columnist on *The Times* since 2001 and is a former executive editor, Chief Leader Writer and comment editor. He is a former chairman of Policy Exchange Ltd, a political think tank, and has been a political adviser to the Conservative Party and to the Social Democratic Party. He was a non-executive Director at the *Jewish Chronicle* between 2011 and 2013. Daniel holds an honorary Doctor of Science degree from City University.

Ian Gibson

Ian Gibson joined the Board in August 2013. Ian retired from Legal & General in 2007 after more than 35 years with the organisation. He is a qualified actuary and has extensive experience of managing and advising on with-profits funds. After retiring from Legal & General, Ian worked as an actuarial consultant providing advice on, among other things, Solvency II and life fund transfers. He has also served on the Supervision Committee of the Life Board of the Institute and Faculty of Actuaries.

Cathryn Riley

Cathryn Riley joined the Board in August 2009. She chairs the Society's Remuneration Committee. In a wide-ranging career covering customer services, IT, operations, human resources and general management, Cathryn has worked for British Coal, British Airways, Coopers & Lybrand, BUPA and latterly Aviva plc where she was Group Chief Operations Officer and a member of the company Executive Committee. She is Chairman of AA Insurance Services Ltd and a non-executive Director of International Personal Finance plc, ACE Underwriting Agencies Ltd, ACE European Group Ltd and Chubb Insurance Company of Europe.

AGM venue

Holiday Inn – Regent's Park
Carburton Street, London W1W 5EE
Tel: 0871 942 9111

Holiday Inn – Regent's Park has excellent transport links by tube from Euston, King's Cross, St Pancras and Paddington to Great Portland Street and from Waterloo to Warren Street.

Nearest underground

Great Portland Street (Hammersmith and City, Metropolitan and Circle lines),Warren Street (Victoria and Northern lines), Regent's Park (Bakerloo line).

Parking

There is an NCP car park that is below the hotel entrance located on Carburton Street (this is chargeable). In addition, there is metered parking in the nearby streets.

Venue access and facilities for the hard of hearing

Holiday Inn – Regent's Park has wheelchair access via the main entrance (on Carburton Street) and also from the NCP car park below. Facilities are available for the hard of hearing; those requiring assistance should ask at the registration desk.

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